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DEPARTMENT OF ENERGY
Federal Energy Regulatory Commission
[Docket No. AD13-7-000]

Centralized Capacity Markets in Regional Transmission Organizations and Independent System Operators

Notice Allowing Post-Technical Conference Comments

On September 25, 2013, the Federal Energy Regulatory Commission (Commission) conducted a technical conference to consider how current centralized capacity market rules and structures in the regions served by ISO New England Inc. (ISO-NE), New York Independent System Operator, Inc. (NYISO), and PJM Interconnection, L.L.C. (PJM) are supporting the procurement and retention of resources necessary to meet future reliability and operational needs.¹

All interested persons are invited to file post-technical conference comments on any or all of the questions listed in the attachment to this Notice. Commenters need not address every question. Commenters are also invited to rely on or cite to testimony that was previously filed in this docket and the technical conference transcript in their comments. These comments must be filed with the Commission no later than 5:00 PM Eastern Standard Time (EST) on Monday, December 9, 2013.

For more information about this Notice, please contact:

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¹ While the Commission recognizes that other regions are considering similar issues, the technical conference focused solely on the centralized capacity markets in the ISO-NE, NYISO and PJM regions. Thus, post-technical conference comments should be focused on those three regions as well.

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Post-Technical Conference Questions for Comment

1. Role of Capacity Markets and Definition of the Capacity Product

Panelists discussed the definition of the capacity product and, in particular, the relationship between the capacity and energy and ancillary services markets, both today and in the future as electric system needs change. In particular, panelists addressed the importance of properly defining the capacity product, and whether additional capacity products should be defined to recognize future system operational needs. Some favored retention of the current design, procuring a single capacity product focused on meeting basic resource adequacy requirements, with any operational attributes needed to meet system requirements procured in the energy and ancillary services markets. Others favored an approach that would procure differentiated products in capacity markets, incorporating attributes that meet specific operational needs. In addition, panelists discussed how different categories of resources (traditional generation, new resources vs. existing resources, demand response, energy efficiency, distributed generation, etc.) should be valued and accounted for in centralized capacity markets.

- When procuring a single capacity product, as under current market designs, are there certain fundamental performance standards that capacity resources should be required to meet in the delivery year to ensure resource adequacy? Should any such requirement change depending on the type of resource (traditional generation, new resources vs. existing resources, demand response, energy efficiency, distributed generation, etc.)?
- Should existing capacity products be modified to reflect various operational characteristics needed to meet system needs? If there is a need for additional capacity products, how should those products be defined and procured in light of the current one day in ten year resource adequacy approach?
- Alternatively, if it is more appropriate to rely on energy and ancillary services markets to obtain needed operational characteristics, how can market participants and regulators be confident that resources capable of providing such ancillary services will be available in future periods? To what extent are the existing categories of ancillary services adequate to meet current and future operational needs without a forward market?
- What improvements are needed in how centralized capacity markets determine qualification as a capacity resource? Do the requirements to participate in the centralized capacity markets accommodate all resources (whether supply-side, demand-side, or imports) that are technically capable of providing the traditional forward capacity product?

- As changes in technology and markets drive new system needs, are modifications needed to existing methods for determining resource adequacy requirements (i.e., the reserve margins centralized capacity markets are designed to procure)?
- What is the role(s) of centralized capacity markets? Should the centralized capacity markets function as a mandatory market for procuring capacity or a residual market that entities only need to use to meet their resource adequacy obligations that they cannot otherwise meet through self-supply?

2. Accommodating state policies and self-supply by load serving entities

As discussed at the technical conference, States have policies to maintain resource adequacy and procure specific resources to meet environmental objectives. In addition, load serving entities are often interested in supplying their own resource adequacy requirements; some load serving entities (LSEs) have suggested that current centralized capacity market designs do not allow them to do so effectively. Incorporating States' policies and LSE preferences in the design of capacity markets has raised challenges for the Commission in ensuring the integrity of its wholesale markets.

- In what ways do the current centralized capacity market designs facilitate, or hinder, the ability of market participants to enter into arrangements to supply their own resource adequacy requirements? Should the Commission consider changes to the current capacity market designs to facilitate these arrangements? How would any potential changes impact capacity market prices paid by LSEs and the price signals provided to capacity resources?
- Some panelists suggested other potential modifications to the existing centralized capacity markets to accommodate self-supply and/or state policies, including limited or resource class-specific exemptions from buyer-side mitigation rules, or offsetting reductions in the amount of capacity procured in the centralized capacity market. What are the advantages or disadvantages of such changes? Are there additional potential changes to particular design elements that should be considered to accommodate self-supply and/or state policies? How would any potential changes accommodate the long-term price signals that several panelists argued are necessary for capacity investment?
- PJM offers LSEs the alternative to opt out of its capacity auction by using the Fixed Resource Requirement (FRR) option. Should such an alternative be offered in other eastern Regional Transmission Organization (RTO)/Independent System Operator (ISO) centralized capacity markets? Given that the FRR option was originally developed to address a narrow set of circumstances facing the PJM region and its market participants at that time, would modifications to this alternative be appropriate to meet the

needs of regions and market participants today? For example, are there changes to the current FRR option that could be adopted to allow increased flexibility for entities looking to partially self-supply their capacity requirements while preventing adverse impacts on the competitiveness of the market?

3. Market Design Elements

Throughout the technical conference, comparisons of the RTO/ISO capacity markets and market design elements were made, including whether there is a need for consistency in the approach to capacity markets across the eastern RTOs/ISOs and the interaction of the capacity market with other RTO/ISO markets. Panelists suggested that consistent approaches with respect to some design elements could improve the ability of market participants to participate in multiple markets.

- **Slope of demand curve.** A number of panelists commented that a downward-sloping demand curve is preferable to a vertical demand curve. What are the advantages and disadvantages of a sloped demand curve versus a vertical demand curve? What are the key design criteria appropriate to consider in establishing the slope of the demand curve in each of the eastern RTO/ISO centralized capacity markets?
- **Derivation of Resource Adequacy Requirements.** Whether using a sloped or vertical demand curve, RTOs/ISOs must attempt to accurately assess future capacity needs in order to ensure resource adequacy in the delivery year. Are there improvements to the derivation of an RTO/ISO's resource adequacy requirement that would improve the functioning of its capacity market? How do differences in the derivation of resource adequacy requirements across the RTOs/ISOs impact the markets? For RTOs/ISOs with three-year forward markets, should the RTO/ISO procure 100 percent of its resource adequacy requirement three years in advance of the delivery year, or is there a portion of the resource adequacy requirement that can be reliably procured closer to the delivery year? What are the advantages and disadvantages of procuring a portion of the resource adequacy requirement closer to the delivery year?
- **Derivation of Net Cost of New Entry (CONE).** Panelists did not focus extensively on the derivation of Net CONE, although it was discussed in the staff white paper. Are there improvements to the derivation of Net CONE that would improve the functioning of capacity markets? How do differences in the derivation of Net CONE across the RTOs/ISOs impact the markets?
- **Length of forward period.** Panelists debated the merits of a longer or shorter forward period in centralized capacity markets. Some argued that a longer forward period can aid in managing retirements; others argued that a

shorter forward period facilitates bilateral contracting. What are the advantages, disadvantages and related considerations that may support longer or shorter forward periods? Should the length of the forward period vary for different categories of resources (traditional generation, new resources vs. existing resources, demand response, energy efficiency, distributed generation, etc.)?

- **Length of commitment period.** Commitment periods also vary by RTO/ISO and by resource-type. Is there an ideal length of the commitment period? Should the length of commitment period vary for different categories of resources (traditional generation, new resources vs. existing resources, demand response, energy efficiency, distributed generation, etc.)? Does the length of the commitment period impact the ability and willingness of buyers and sellers to enter into bilateral contracts? How do differences in commitment periods across the RTOs/ISOs impact the markets?
- **Zones.** Some panelists at the technical conference asserted that capacity market zones are not sufficiently granular and do not change often enough to reflect important market and system changes. Are there advantages or disadvantages associated with increasing the granularity of capacity zones? If so, what are they? What are the challenges, advantages or disadvantages of a dynamic approach to establishing capacity zones?
- **Coordination of transmission planning and capacity market.** Price signals in the capacity markets also provide information to transmission planners to the extent that transmission may substitute for capacity resources. How can investment in capacity and transmission planning be better coordinated? Should the capacity market planning process and transmission planning process use common assumptions and common planning horizons?
- **Retirement notice.** What role do retirement and mothballing decisions and notification play in the operation of the eastern RTO/ISO centralized capacity markets? Is there an ideal approach to retirement or mothballing notification? What is the impact of different retirement or mothballing notice procedures across the eastern RTOs/ISOs on the market, resource adequacy and reliability?

4. Regulatory certainty

Several panelists stated the importance of regulatory certainty in achieving capacity market stability. Regulatory certainty reduces risk and thereby lowers barriers to entry in capacity markets. Conversely, some panelists identified significant market design issues that, if resolved, could improve capacity market efficacy. While recognizing that regional differences may be necessary, some

panelists suggested that a minimum level of best practices across the three eastern RTO/ISO centralized capacity markets also would lead to greater regulatory certainty and provide inter-regional benefits.

- How should the Commission strike a reasonable balance in adopting market rule changes when necessary without creating undue regulatory uncertainty?
- What are the advantages and disadvantages of an RTO/ISO regularly revisiting certain market design elements, such as NYISO's triennial reset of its capacity demand curve?

5. Next steps

Conference panelists indicated that further direction from the Commission could help to inform the development of appropriate eastern RTO/ISO centralized capacity market design elements in the future.

- What Commission action would be an appropriate next step with respect to those markets?
- Are there outstanding issues or questions raised by, but not fully discussed at, the conference that should be considered in this proceeding?
- Are there other issues that, if addressed, would help the centralized capacity markets ensure resource adequacy in a just and reasonable and not unduly discriminatory manner (e.g., enhancements to the energy and ancillary services markets) that should be considered by the Commission in another forum?

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